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TESTIMONY OF FRANK TORRES

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Committee on Financial Services
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Consumers Union¹ appreciates the opportunity to appear today before the Financial Services Committee to present the consumer perspective on the rule proposed by the Federal Reserve Board and the Department of the Treasury. The proposed rule would allow financial holding companies and financial subsidiaries of national banks to engage in real estate brokerage by determining that real estate brokerage is an activity that is financial in nature or incidental to a financial activity.

Consumers Union has long been involved in financial issues related to the modernization of this country's banking laws, including the passage of the Gramm-Leach-Bliley Act (GLB), discussions of the laws related to home-buying, mortgages and home equity loans, and efforts to curb predatory lending practices.

Consumers Union participated in a group of lenders, other consumer advocates, regulators and other industries involved in the real estate and mortgage industries - the self-named "Mortgage Reform Working Group." While the group did not reach ultimate conclusions of how to reform the Real Estate Settlement Procedure Act (RESPA) or the Truth-in-Lending Act (TILA), the work of the group proved useful to the Federal Reserve Board and Housing and Urban Development in their report to Congress on RESPA/TILA reform. Consumers Union was also a member of the Joint Treasury/HUD Task Force on Predatory Lending. Currently, Consumers Union serves as a member of the Consumer Advisory Committee of the Federal Reserve Board.

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Everyone agrees that buying a home is the largest single transaction most consumers will make. It is vital for the regulators and Congress to focus on whether consumers will, in fact, benefit from changes in the marketplace that will occur should the rules be changed. Consumer advocates across the country are struggling with the challenge of making sure the process of buying a home is fair for consumers. This includes looking at the practices of the real estate industry as well as those of lending institutions.

The proposed rule raises several issues. Is this allowable under GLB? Will consumers benefit? Should the rule move forward, what reasonable expectations, including regulatory measures, are warranted prior to the banks being allowed to act as real estate brokerages?

IS THIS EXPANSION OF BANK POWERS ALLOWABLE UNDER THE GLB ACT?

What the Law Says

The GLB Act allows banks to engage in activities that the Department of the Treasury and the Federal Reserve Board determine to be financial in nature or incidental to a financial activity. The GLB Act includes a list of factors to be used in making the determination of whether an activity is financial in nature or incidental to a financial activity, including the purposes of the GLB Act; changes in the marketplace; changes in technology for delivering financial services; and whether the proposed activity is necessary or appropriate to allow a bank to compete effectively, efficiently deliver financial information through technological means.

Congress also included a list of activities that are considered to be financial in nature. Those include lending, exchanging or safeguarding money; insuring against loss; providing financial advisory services; selling financial instruments; and, underwriting.

Congressional Intent

The debate over financial modernization lasted an entire decade. Congress had ample opportunity to specifically address an issue of this magnitude during that time. Instead, Congress did not include real estate brokerage on the list of permissible activities.

Further, during the debate on financial modernization, Congress was willing to include language in the law so that financial institutions were not disadvantaged because of changes in technology that might effect the marketplace. Congress did not appear to be endorsing the notion that financial institutions be allowed to engage in a commercial activity simply because they petitioned the regulators. Rather Congress tried to anticipate the possibility of future developments. Simply put, Congress did not want to reopen the discussion on financial modernization with each new development in technology.

The GLB Conference Report itself states that providing health care is not incidental to the business of insurance. It seems that this is an appropriate analogy. If the proposed rule is

adopted it would seem that if a payment is made for a product or service that business would be considered "incidental" to banking and banks would be permitted to engage in that business. It would be hard to imagine any business activity that would not be fair game for the banks.

Recent Congressional action supports the notion that the GLB Act was not intended to allow banks to become real estate brokers. It is our understanding that over 150 members of Congress, including members of the Financial Services Committee, have sent letters to the regulators urging them to reject allowing banks to engage in real estate brokerage. The letters make it clear that Congress did not intend for banks to engage in this type of activity when it passed the GLB Act.

One letter stated that allowing banks to become real estate brokerages "would be a significant departure from prior positions regarding holding company involvement in real estate activities and a significant shift from the intent of the Gramm-Leach-Bliley Act." The letter concluded, "Congress specifically decided not to permit holding companies and banks to expand the definition of financial activities to include real estate."

Concerns about Mixing Banking and Commerce

The proposed rule raises the issue of mixing banking and commerce. One of the potential consequences of financial modernization – the mixing of banking and commerce – has been debated at length. During consideration of the GLB Act, many members expressed concern of breaking down all of the firewalls between financial institutions and commercial activities.

The GLB Act specifically focused on allowing banks, insurance companies and securities firms to combine, but was careful not to stretch the reach of financial institutions. In fact, one of the letters sent by House members on the proposed rule emphasized that Congress "rejected" the mixing of banking and commerce of the type that would occur if banks were allowed to engage in real estate brokerage activities.

Consumers Union shares those concerns. During the debate on financial modernization, Consumers Union testified that:

While banking laws need to be modernized, Congress needs to ensure that they are done in such a way as to preserve the safety and soundness of the banking system. Congress must be vigilant to protect against a repeat of the same mistakes that forced taxpayers to pay billions to bailout the savings and loan industry.

We oppose permitting federally insured institutions to combine with commercial interests because of the potential to skew the availability of credit, conflict of interest issues, and general safety and soundness concerns from expanding the safety net provided by the government. The federally insured deposit insurance

system should not be put at risk merely because companies have holding in commercial firms or want to expand into such businesses.

CONSUMER BENEFIT IS QUESTIONABLE

Today's Marketplace

Banks already have a significant presence in providing financial services related to the home buying process, including the exploding subprime market. According to bank regulators between 1993 and 1998 the number of subprime mortgage loans originated by banks increased by 551 percent. Banks are either merging with subprime lenders, or have subprime affiliates. Under the GLB Act banks are guaranteed the ability to offer a wide range of financial products to their borrowers. Some of those products may be good, others, like credit life insurance, more of a rip-off. But financial institutions have the ability to offer those products to consumers.

Improving the Marketplace

The consumer advocate community is not convinced of the benefits of "one-stop-shopping." Too often, the promises of better quality at a lower cost for consumers are not seen by the majority of consumers in the marketplace. In fact, consumers face substantial burdens in dealing with lenders where the lenders already have a presence in the real estate marketplace.

Consumers Union and other consumer advocates are trying to figure out ways to allow consumers to shop for loans, including giving consumers the ability to compare loans on the basis of rates and fees. A consumer would then be able to compare one lender's products with other lenders and use that information to negotiate the cost of the loan. That would be a sign that the marketplace was competitive. Most of our efforts to change the business practices to allow consumers to shop have been rebuffed by the financial service community.

The proposed rule may erode some of a consumer's ability to effectively shop for the best loan. They may wind up "stuck" with the loans offered by their agent/lender or feel as though their options are limited. There will be no incentive for the agent/lender to offer products from other lenders even though those loans may be better suited for the borrower. Steering could be a problem as it is unclear if existing anti-tying prohibitions would apply to the relationship between the bank's real estate agent services and their mortgage lending business. Even if the anti-tying provisions did apply, they would likely be difficult, if not impossible, to enforce, especially given the potential for "capturing" consumers by banks acting as real estate agents.

The financial services industry implies that consumers will benefit from their participation in the marketplace as real estate brokers. Yet, the banks have not provided any concrete assurances that consumers will benefit through lower costs or better products. Many

consumers have not yet realized the banking industry promises to consumer in the aftermath of GLB. Many consumers have not seen lower banking costs. Bigger banks are still charging higher fees. ATM fees have increased substantially. There are more charges now than ever related to credit cards. With regards to mortgage loans there seems to be a push to sell more products - some, like credit life insurance, are of little or no benefit to consumers but generate high fees for the bank. In addition, many consumer advocates are concerned that consumers in the subprime market may qualify for better priced loans. Those consumers are often never referred up the credit ladder, even if it is to an affiliate of the lender.

Problems with Predatory Lending

Predatory lending continues to be a problem for consumers, particularly lower and moderate income working families and the elderly. The banking industry has opposed almost every attempt by consumer advocates to curb predatory lending practices.

The Federal Reserve Board has identified several elements related to predatory lending:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
- Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced;
- Concealing the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

We and other consumer advocates support in general the rules recently proposed by the Federal Reserve Board to lower the HOPEA triggers and to expand reporting under the Home Mortgage Disclosure Act (HMNDA). The hope is that both of these actions will limit abusive practices in the short-run. The Board's description of predatory lending, as well as its proposed regulatory changes, are consistent with the direction provided by the House Banking Committee last year during a hearing on predatory lending. Then-Chairman Jim Leach offered a list of "Anti-Predatory Lending Precepts," and urged the regulators to exercise their authority under existing laws to prevent some of these practices. Using existing authority is not the complete answer to predatory lending, but it is a step in the right direction.

Instead of embracing these modest proposals, or other efforts at the state and local level to curb predatory lending, the financial services community has sought repeatedly to defeat those proposals. Often we hear the cry from lenders that they will "reduce credit availability" if predatory lending practices are prohibited. If lenders cannot abide by restrictions on predatory lending, then they should not make the loans. We agree with the Federal Reserve Board that "A borrower does not benefit from ...expanded access to credit if the credit is offered on unfair terms or involves predatory practices." An institution should not have to rely on predatory lending practices to survive. If the financial marketplace is competitive, there should be lenders willing to make subprime loans.

The financial institutions that petitioned the Federal Reserve Board to conduct this rulemaking are some of the largest in the country. Yet, they have provided no concrete assurances of substantive improvements for consumers regarding their lending practices. What assurances are there that if the rule is adopted and those financial institutions will engage in real estate activities that consumers will see any improvements?

Other Improvements to the Marketplace Should be Made

In addition to expanding the scope of HOPEA and HMDA under existing authority, Congress should specifically mandate other requirements to level the playing field and to give consumers the tools they need to effectively shop for a home and mortgage and to truly ensure that the marketplace is competitive.

One way Congress could help consumers is to require mortgage lenders to provide a guaranteed interest rate and closing costs before collecting any application fees from consumers. This was one of the recommendations made by HUD in its report to congress. The report specifically stated that, “consumers be provided guaranteed information about closing costs, interest rate and points early enough so that they can shop and make informed choices.”

The proposed rule may have an impact on the application of Section 8 of the Real Estate Settlement Procedures Act (RESPA). Section 8 prohibits kickbacks between lenders and mortgage brokers for steering customers. One of the problems consumers face in obtaining a mortgage is the inability to effectively shop for a loan on the basis of the interest rate and fees. Consumers cannot realistically apply for more than one loan at a time. Some proposals have been put forward to guarantee closing costs. While this is a first step, unless a consumer can shop for an interest rate, effective shopping for a mortgage will not be a reality.

As long as a borrower must pay a significant sum of money before a guaranteed loan price is provided to the consumer, there is nothing to prevent the price of a loan from being increased prior to closing. If the agent and lender were part of the same company, it is questionable whether the same prohibitions against referral kickbacks would apply. If, however, a consumer could shop for several loans at the same time, and receive firm price quotes, it would not matter what fees were paid, either to a broker or through internal bookkeeping mechanisms. The borrower would be able to compare firm prices between lenders and choose the best deal.

Increased Privacy Intrusions

Every day American consumers seem to lose more of their privacy. Poll after poll show that the public is concerned about the lack of privacy and want lawmakers to do something about it. Efforts to reign in the collection and use of personal data fail to provide full protections. Some existing laws, like the GLB Act are riddled with loopholes to allow the continued collection and use of personal data under most circumstances.

Real estate transactions can provide a wealth of personal information about the homebuyer and the homebuyer's family. Specific preferences, likes and dislikes, any aspect of the homebuyer's decision making process would be fair game for the financial institution. That data could be paired with other data already held by the financial institution and used to create consumer profiles.

A recent survey conducted by the National Association of Realtors showed that consumers are concerned about the potential loss of privacy if banks are allowed to act as agents. This is consistent with the opinion of the American public generally when it comes to privacy.

Consumer concerns about the privacy of their information might be diminished if Fair Information Practices were put into place to govern the collection and use of data. Often consumers are not aware that data is collected about them, or that the information they provide, for example, to open an account, is then used for another unrelated purpose. Consumers typically do not have access to the data that is collected about them.

Congress should examine how consumer information is collected and used during real estate transactions. To the extent privacy intrusions exist in the current marketplace then protections should be put in place. Before financial institutions are allowed to engage in real estate brokerage additional safeguards will likely be necessary to provide consumers with the privacy safeguards they want.

IF THE RULE PROCEEDS CONSUMERS WILL NEED SAFEGUARDS

Need for Further Examination of the Impact of the Proposed Changes

We urge Congress to send a clear signal to the regulators that they should not move ahead with the rulemaking until there has been ample time to conduct additional investigations, including further hearings if necessary, into the questions raised by this proposal. Enough questions exist about the implications of the proposed rule – the mixing of banking and commerce, concerns about safety and soundness, competition in the marketplace, benefits (or lack of benefits) for consumers, concerns about increased loss of privacy, and the need for consumer safeguards -- that additional examination and scrutiny is prudent. If the regulators determine that this is a permissible activity under GLB Act, consumer safeguards should be put in place prior to the rules taking effect.

Hold Hearings on How Consumers are Treated in the Real Estate Marketplace

We also call on Congress to hold hearings on the real estate marketplace. In addition to RESPA/TILA and predatory lending, other issues warrant examination. Are consumers being treated fairly by real estate brokers? Are commissions priced fairly?

Now may be the time to discuss a “Home Buyers Bill of Right” that would include substantive protections dealing with the relationship between a consumer and the various elements of the real estate industry, including agents, appraisers, lenders and the like. Such a proposal should include a suitability requirement for mortgages and home equity loans.

CONCLUSION

Consumers already face a tough time in the marketplace when they go to obtain a mortgage. Congress should not allow the regulators to change the rules in a way that could potentially harm consumers and offer no real benefit. Consumers could be harmed if appropriate safeguards are not put into place prior to those changes.